

MR. KUBARYCH: Thanks very much. I'm very delighted to have a chance to be here. The Commission has a tremendous depth of experience, and any number of you could make my remarks better than me.

So I'd like to focus a little bit on maybe a little comparative advantage. For the last 12 years with my friend and partner, Henry Kaufman, we've been managing money for large foreign institutions, as well as domestic institutions, and you learn a little bit about the thinking of at least some of the larger foreign investors, including investment funds, insurance companies, banks, and so on.

I would agree that for the time being this is not an issue to cause high anxiety, and I think that the reasons are straightforward. You asked the question: Why are foreign markets so attractive. Why are U.S. markets so attractive to foreign investors? And the answer is for the same reason that they're attracted to Americans.

The economic data are terrific. The high tech boom has had a kind of halo effect that has dazzled people so that they do not pay as much attention to longer-term vulnerabilities, and there's a broader dimension as well.

Foreign investors are very impressed, as well as Americans, about the broad, almost bipartisan

consensus about a number of positive factors in organizing economic policy. One is a commitment to fiscal discipline. One can argue about the exact shape of that fiscal policy, but certainly we have at least the most disciplined approach to fiscal policy we've ever had.

Another is an independent Central Bank that is fully pursuing monetary policy on a professional and highly operationally competent basis.

Also important is our philosophical commitment to open markets and an enterprise driven economy, which is also bipartisan.

And a further strength is that the American model is not doctrinaire. We have a belief in the benefits of a powerful infrastructure of law, of official regulation, and self-policing by market participants, and this is admired by foreign investors.

They don't always have this kind of regulatory infrastructure themselves. Where they have invested in countries with troubles, they have felt the pain stemming from the lack of that legal and regulatory infrastructure. It is an important source of strength for our markets.

Now, it's very important to realize that foreign investors have not been aggressively in the mainstream of investing in the U.S. stock market. They

have taken part. They have done well. Their share of U.S. overall equity ownership has drifted up a little bit over the last five years, but the bulk of where foreign investors matter the most for our financial markets is in the bond market.

And as a result we now have a situation where a trillion dollars of bond investments have been made by foreign investors in the last few years. If you take U.S. Treasury obligations, foreign investors are now a third of total ownership of U.S. treasury obligations, which is double the ratio of 10 years ago.

So when you ask; Is foreign investment here sustainable, you're really asking about foreign investment in our bond markets. And all of those factors really boil down to this: Are we committed to keeping the inflation rate low, making for honest money, or not?

And I think that right now foreign investors are quite convinced that we are. And I think they'll stay convinced as long as the kind of balance in monetary and fiscal policy that Gerry Corrigan just talked about is preserved, notwithstanding the fact that we do have some opportunities, given the large surplus, to do some things.

Now, let me finish up with what could go wrong. Where are the risks?

Well, the first risk, because of this halo effect that I mentioned, is if the high tech bubble should burst. Now, let me just remind people about one of the benefits of getting past 50, as Bob Dugger mentioned, is that you have accumulated a little bit of memory of the past.

Let me take you back to 1967 and 1968. This country had a high-tech bubble. Computer companies, technology companies galore reached price earnings ratios that are familiar to us now, but we really haven't seen in the meantime.

Take one company you've all heard of, Control Data. It peaked in 1967-1968 at a high of 163. Within two years it had fallen to 28, a decline of 83 percent.

Take another one just for an illustration. EDS, Electronic Data Systems, which has had quite a history ever since, hit a high of \$162 a share in that period, reached a 1970 low of 24, a decline of 85 percent.

In fact, I have a list of about three dozen stocks, very similar in spirit to the kind of stocks which have been performing so bubblingly well in recent days, where the average decline was 88 percent from the peak of 1967-68 to the low point in 1970. (SEE INSERT 12)

If you go back and read the brokerage reports and read the headlines of that period, you will see language that looks absolutely identical to what you're reading today. It was also a period of computerization of American industry that in many respects was more profound than what we have now, which is certainly wonderful. And I use the Internet myself at least six to eight hours a day as part of the research that I'm doing for a book. But frankly, when you saw how banks were operated in the early '60s, and as they are in some parts of the world today, and you see the computerization that took place, that was definitely a revolution then, and high tech companies were bid up to staggering magnitudes then.

Now, I know that Dell, which has gone up 90,772 percent in the decade of the '90s, is a fine company and others as well, but not all of the high tech companies will deliver the earnings that the buyers expect.

And when they don't, and if there's any kind of a slip up, foreign investors are going to rethink, and it's going to have an impact in their desired holdings of U.S. assets.

Now, number two, another dark cloud on my list is a slowdown in the U.S. economy that might incite demands for more protectionist stands on trade

policy. Let's face it. Foreign investors would see this as terribly inflationary when you've got an economy with four percent unemployment, and they would not believe that the Fed would have an easy time dealing with the inflationary consequences of really protectionist measures. That would have a chilling effect on foreign investment, the smoothness of its coming in.

Number three is any overt attempt to weaken the dollar. Now, it is true that most foreign investors, certainly our clients, believe that the dollar will ease back somewhat, and you see that displayed vividly in the structure of forward exchange markets. It's already in there in the expectation structure, but a manipulative approach that would essentially abandon the current U.S. Treasury posture - - which is that a strong dollar is in the interest of the U.S. -- would, I think, trigger sizable outflows of funds from the U.S. markets, and that might have an effect on bond and stock market valuations.

Number four, and this is broader, but you do get this very often when you talk to foreign investors, and that is the mishandling of foreign relations more broadly cast. Right now we have seven, at least seven -- rifts with our European partners over a range of issues ranging from IMF governance to

bananas to hormones and beef to aircraft noise and to the adverse WTO ruling against foreign sales corporations.

We've latent problems with Japan that could break out into the open. We have the issue that, as Gerry and others have mentioned, of WTO membership for China, and so on. There's a matter of how to deal intelligently with an erratic Russia; the broad question of how to deal with a reinvigorated OPEC.

These are very tough foreign policy considerations. Foreign investors expect the U.S. to behave as a super power and not with narrow nationalist economic policy agendas.

And finally, and the one that I'm most confident about, is foreign investors expect and will insist on a firm monetary policy response to any significant increase in the inflation rate. I believe there will be. If there isn't, there would be problems.

Those are my comments.

CHAIRMAN D'AMATO: Thank you very much, Mr. Kubarych.

Mr. Madrick.

*Chart accompanying Roger Kubarych's Testimony before The United States Trade Deficit Review Commission, March 13, 2000, in New York City.*

### **The 'Glamours' of 1967-68**

	<b>P/E at High</b>	<b>Price at '67- '68 High</b>	<b>Price at 1970 Low</b>	<b>% Decline</b>
<b>Computer Stocks</b>				
Control Data	54	163	28	-83
Mohawk Data	285	111	18	-84
University Computing	118	186	13	-93
Data Processing Financials	38	92	6	-94
Leasco Data	31	57	7	-88
Levin-Townsend	352	67	3	-96
Electronic Data Systems		162	24	-85
<b>Technology Stocks</b>				
Optical Scanning	200	146	16	-89
Itek	71	172	17	-90
Recognition Equipment	—	102	12	-88
Fairchild Camera	443	102	18	-82
EG&G	100	72	9	-88
General Instruments	42	63	11	-83
Kalvar	—	73	11	-85
<b>Conglomerate Stocks</b>				
Litton Industries	57	104	15	-86
Gulf & Western	24	66	9	-87
Ling-Temcon-Vought	47	135	7	-95
Bangor Punta	24	61	5	-93
Kidde	28	87	15	-82
ATO	—	74	6	-92
Teledyne	42	72	13	-82
Northwest Industries	23	60	8	-87
United Brands	44	58	12	-80
<b>Average</b>	<b>103</b>			<b>-88%</b>

*Source: Ned Davis Research*